

EX PARTE OR LATE FILED

ORIGINAL

WILEY, REIN & FIELDING

1776 K STREET, N. W.
WASHINGTON, D. C. 20006
(202) 429-7000

DONNA COLEMAN GREGG
(202) 429-7260

RECEIVED

FACSIMILE
(202) 429-7049

AUG - 5 1994

August 4, 1994
DOCKET FILE COPY ORIGINAL

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Mr. William F. Caton
Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: Notification of Permitted Written Ex Parte
Presentation in MM Docket Nos. 92-266/& 93-215

Dear Mr. Caton:

ParCable, Inc. by its attorneys and pursuant to Section 1.1206(a)(1) of the Commission's rules, hereby submits two copies of this memorandum regarding a permitted written ex parte presentation to Commission officials regarding MM Docket Nos. 96-266 & 93-215.

Michael Grannon of ParCable, Inc. submitted the enclosed material to Patrick Donovan, Deputy Chief of Cable Services Bureau and Hugh Boyle, Accountant, Cable Services Bureau. The materials relate to issues raised in the above-named company's pleadings in the cable rate regulation dockets cited above.

Kindly direct any questions regarding this matter to the undersigned.

Respectfully submitted,


Donna C. Gregg

DCG/ddl
Attachment

cc: Patrick Donovan
Hugh Boyle

No. of Copies rec'd
List ABCDE

041

ParCable, Inc.
250 West 57th St., Room 1321
New York, New York 10107-0165
Tel: 212-541-6702
Fax: 212-333-5374

RECEIVED

July 19, 1994

AUG - 5 1994

Mr. Patrick J. Donovan
Federal Communications Commission
Office of Division Chief
Cable Services Division
2033 M Street, N.W., Room 918B
Washington, DC 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Re: MM Docket Nos. 92-266 and 93215

Dear Pat:

Thank you again for taking so much of your time to meet with us.

After the meeting I revised the charts we discussed. I've enclosed copies of these revised charts as well as some notes that go along with them. In the notes I tried to address the major points we talked about at our meeting.

The charts were revised in the following manner:

1. I realized I had made a mistake regarding the treatment of interest. The method the FCC used to determine its weighted average cost of capital utilized a pre-tax cost of debt and an after-tax cost of equity. My previous charts assumed that all costs of capital were after-tax. The "Base Year" in the new charts show how the after-tax weighted average cost of capital would work using the cost of service format, as well as the FCC's defined weighted average cost of capital. The new charts show that the two "Base Year" methods result in the same net results for the Revenue Requirement and Earnings Retained In The Business. In other words, the FCC's method of subtracting interest from Return On Investment before determining the allowance for income taxes does work properly.

2. Titles were expanded to be more clear and to include all formulas and, in the case of Example 2 and Example 3, to include a reference to the comparable cells in FCC Form 1205 where appropriate. The Notes at the bottom were also updated;

3. The formulas in rows F and I of Example 1 were simplified;

4. The gross-up formula in row I of Example 1 for S Corp's was corrected to correspond to the proper formula; and

5. I figured out how to make columns II and III of Example 3 completely correspond to the results in Example 1 by revising the formulas of rows K and L, which correspond to cells G6e and G7 in FCC Form 1205. These revised formulas are noted in Example 3.

I've enclosed a diskette copy of the three files containing Examples 1, 2 and 3 for your use (to double check formulas, etc.). The files were created using 123 for Windows, version 4. My IBM compatible computer uses DOS 6.2 and Windows, version 3.1.

Please let me know if I can provide you with any further information to help you in your decision making process.

Sincerely,



Michael L. Grannon
Assistant Secretary

Notes To Example 1, Example 2 and Example 3

Example 1

This example computes the revenue requirement of sample cable companies in the format of the cost of service rules.

All formulas are noted, except for B1 in column I, which is noted below.

The "Base Year" shows how the Revenue Requirement would be determined, if C Corp's and Sub-S corporations, partnerships and sole proprietorships ("Sub-S Corp's") were treated the same under FCC rules, utilizing two different Rate of Returns as described in more detail below.

The "First Year" shows how the Revenue Requirement would be determined using the FCC "revised" rate rules, assuming the same fundamental cost and capital structure as the Base Year.

Revenue Requirement Calculations utilize rate setting rules to derive the annual revenue requirement.

Earnings Retained In The Business Calculations assume the revenue and other expenses determined immediately above actually occur and then utilize normal income tax paying rules to determine what income taxes would be due and thereby what earnings would be retained in the business before any C Corp dividends/Distributions to S Corp shareholders (above the amount of such income taxes due).

Column I:

The Revenue Requirement is calculated in this column using a fully after-tax weighted average cost of capital for the Rate of Return. This rate was calculated by subtracting the "income tax portion" of the cost of debt from the FCC's estimate of an 11.25% weighted average cost of capital for the cable industry. To do this, an imbedded cost of debt of 8.5% was assumed (the same rate that was estimated by the FCC for the cable industry). The formula was: $11.25\% \text{ minus } ((8.5\% \text{ times } 35\%) \text{ times } ((\$500,000 / 8.5\%) / \$10,000,000))$, where 35% is the income tax rate, \$500,000 is the interest expense and \$10,000,000 is the assumed total capitalization.

1. Note that the Fair Return On Investment equals Earnings Retained In The Business and the allowance for income taxes equals the actual income tax liability that would have arisen from these revenue and expense results (assuming the same accounting for rate setting, financial reporting and tax paying purposes) - as is the intent of rate setting principles.

Column II:

The Revenue Requirement is calculated in this column using the "revised" rate rules methodology.

1. Note that the Revenue Requirement and Earnings Retained In The Business in column II are equal to the results in column I. While the allowance for income taxes is less than the income taxes due in column II, the Return On Investment provides enough funds to cover the rest of income taxes due and the appropriate after-tax Earnings Retained In The Business.

2. Also note that the results are exactly the same for the C Corp and Sub-S Corp, if the Sub-S Corp's distributions to its shareholders equal the income taxes due to the operations of the cable company and these distributions are not subtracted from the Return On Investment before determining the allowance for income taxes, at least up to the corporate income tax rate.

Of course, the Sub-S Corp shareholders actually will have more income taxes to pay on the cable entity earnings because their top rate is 39.6% versus the top corporate rate of 35%.

Column III:

This column shows how the revenue requirement would be calculated under the "revised" cost of service rules for C Corp's.

1. Note that these results are identical to those in column II.

Column IV:

This column shows how the revenue requirement would be calculated under the "revised" cost of service rules for Sub-S Corp's.

The Shareholder Distributions in row G equal the income taxes due in columns I and II (row Q).

1. Note that the Revenue Requirement and earnings Retained In The Business are less than those for C Corp in column III and less than those in the Base Year in columns I and II.

2. As was pointed out in our reply comments (Petition For Reconsideration, dated May 16, 1994, of Bend Cable Communications, Inc., Etan Industries, Inc., ParCable, Inc., River Valley Cable TV and Star Cable Associates), shareholders of Sub-S Corp's pay the income taxes that arise from the earnings of Sub-S Corp's cable business operations.

Since the cable company created these income tax liabilities for their shareholders, most Sub-S Corp's distribute the amount

of income taxes due because of its operations to its shareholders to fund the payment of those income taxes by the shareholders to the taxing authorities.

These "pre-tax" earnings distributions are comparable to a C Corp paying their taxing authorities directly, rather than C Corp's paying dividends out of "after-tax" earnings to their shareholders.

Deducting Sub-S Corp distributions that ultimately went to the taxing authorities means that a Sub-S Corp will never be able to obtain an allowance for income taxes that equals its actual income taxes due. This will be true even if all other earnings are retained in the business. It will also be true even though none of the distributions end up with the shareholders, but rather only with the taxing authorities - just as tax payments do by C Corp's.

Therefore such distributions should not be used as offsets to the Fair Return On Investment when determining the allowance for income taxes for Sub-S Corp's.

3. Any further distributions to shareholders of a Sub-S Corp's "Earnings Retained In The Business" will have the same effect on the cable entity and the rate payers as a dividend payment by a C Corp of its "Earnings Retained In The Business", absent the "revised" rules.

In both cases, an allowance for "corporate" income taxes has been attributed to these "retained earnings" and **in both cases** no additional allowance for "personal" income taxes ("double taxation") is being counted in the revenue requirement.

The C Corp shareholder will have additional personal income taxes to pay as a result of such dividends ("double taxation") but the rate payor does not reimburse these personal income tax payments. There are no such "personal income tax" payments created by distributions of earnings to Sub-S Corp shareholders and therefore the rate-payor is unaffected by such distributions as well.

The allowance for income taxes that the rate payor has reimbursed the Sub-S Corp is based **solely** on the earnings of the cable entity and is analogous to corporate income tax payments not "personal income taxes" based on other personal income of the Sub-S Corp shareholder. No "personal" income or deductions are used to determine the allowance for income taxes that a rate payor reimburses for a Sub-S Corp. In fact, this income tax allowance is the same for the C Corp and the Sub-S Corp in all the examples (without consideration of the FCC's new requirement to offset for Sub-S Corp shareholder distributions).

Therefore C Corp's and Sub-S Corp's should be treated equally for any such distributions/dividends to their shareholders.

Further, as we mentioned in our meeting and as was confirmed by the electric utility trade group and state rate regulatory commission we contacted, the Fair Rate of Return, containing the industry's after-tax weighted average cost of equity, has already taken into consideration the weighted average industry dividend policy. It reflects the appropriate return to be earned by the business entity taking into account the disposition of retained earnings by the business entity.

Public utilities generally pay very healthy dividends **but do not** have to deduct these dividends from their fair returns on investment for rate setting purposes (at least neither we, nor our accountants, attorneys, investment bankers or the electric utility trade group nor state rate regulatory commission, to which we were referred by our commercial bankers, are aware of any situations where dividends are so deducted by rate regulated companies). In fact, investors in public utilities rely on these dividends for a major portion of their expected returns.

There is nothing so unique about cable companies that should require them to be held to a different standard.

Essentially the FCC is saying to Sub-S Corp's that their Fair Return On Investment is only valid to the extent that the returns are retained in the business.

However, if all rate based regulated companies were to be treated in this manner, capital flow to this entire segment of American industry would shrink dramatically, since not every investor is willing to wait to perpetuity or until their investment is sold to obtain any return.

To the extent earnings are not retained and reinvested in the business, the company's net asset base would shrink and rates consumers would pay would decrease. Therefore managements must decide how much retained earnings to distribute to shareholders to keep capital flowing into the company and how much to reinvest in the business to continue to grow.

In either case the rate payor is not affected, since the regulator has decided what a fair return on the company's equity is before the actual disposition of retained earnings is made.

Again, this entire issue is already taken into consideration in the fair rate of return that the FCC has already decided upon.

Therefore Sub-S Corp's should be treated the same as C Corp's and there should be no off-set, for ANY distributions to Sub-S Corp shareholders, to the Fair Return On Investment when determining the amount of the allowance for income taxes.

Example 2

This example computes how the Revenue Requirement and Earnings Retained In The Business would be determined, using the same data as in Example 1 but utilizing the revenue requirement determination methodology of FCC Form 1205.

All rows that correspond to a row or cell in FCC Form 1205 are so noted.

All formulas are noted, except B1 in column I, which is noted above.

The final results should be the same as in Example 1, but are not the same in columns III and IV.

The reason is that there are incorrect formulas in FCC Form 1205 in cells G6e and G7.

These formulas are corrected in Example 3.

Example 3

This example is done in the same format as Example 2 but has corrected formulas in the cells that correspond to FCC Form 1205 cells G6e and G7.

All rows that correspond to a row or cell in FCC Form 1205 are so noted.

All formulas are noted, except B1 in column I, which is noted above, and the rows and cells containing the corrected formulas are in bold type (rows K and L in Example 3).

The results in Example 3 match those in Example 1 and therefore all the comments made in Example 1 apply here as well.

However, in addition, the FCC needs to correct the formulas in FCC Form 1205, cells G6e and G7, to what is in Example 3 or the equivalent.

Conclusions

1. Sub-S Corp's should be treated the same as C Corp's and NEITHER should have to deduct ANY shareholder distributions from Return On Investment when determining the allowance for income taxes.

2. The FCC needs to correct the formulas in FCC Form 1205 for cells G6e and G7.

July 13, 1994

Comparison of Disparate Effects of New Rules On Income Tax Reimbursement Between C Corporations and S Corporations, Partnerships and Sole Proprietorships ("S Corp's")

**Assumed Results For Base Year For Both C Corp And S Corp Cable Company Examples With Differently Determined ROR's
(Assuming Same Regulatory Treatment For C Corp And S Corp)**

First Year's Results Based on Base Year's Expense Structure Under "Revised" Rate Rules:

Revenue Requirement Calculations		I Results For C Corp & S Corp Cable Companies If ROR (B) Is All After-Tax		II Results For C Corp & S Corp Cable Companies If Debt Portion Of ROR (B) Is Pre-Tax And Equity Portion Is After-Tax		III For C Corp - Allowed For Rate Setting		IV For S Corp - Allowed For Rate Setting	
ROI									
A	Net Investment In Assets		\$10,000,000		\$10,000,000		\$10,000,000		\$10,000,000
B	Fair Rate of Return p.a. (Debt = Pre-Tax; Equity = After Tax)		11.25%		11.25%		11.25%		11.25%
B1	Fair Rate of Return p.a. (Debt and Equity = After Tax) (See Separate Notes For Formula)		9.50%		na		na		na
C	Fair Return On Investment p.a. (Column I = A * B1); Rest = (A * B)		\$950,000		\$1,125,000		\$1,125,000		\$1,125,000
D	Less: Annual Interest Expense				\$500,000		\$500,000		\$500,000
E	Equals: Interest Adjusted Fair Rate of Return p.a. (IAFROI)				\$625,000		\$625,000		\$625,000
Expenses									
Income Tax Allowance									
F	Annual Income Tax Allowance On IAFROI - If Only Federal Income Taxes @ 35.0% Base Year I = Grossed-Up By ((E* 35)/(1-.35)) Base Year II And C Corp First Year = Grossed-Up By ((E* 35)/(1-.35))		\$511,538		\$336,538		\$336,538		na
G	S Corp Shareholder Distributions (=s Base Year Income Taxes Paid)				na		na		\$511,538
H	S Corp Interest And Distributions Adjusted Fair Rate of Return (IADAFROI) (E - G)				na		na		\$113,462
I	First Year Income Tax Allowance: C Corp = F; S Corp = Allowance On IADAFROI - If Only Federal Income Taxes @ 35.00%: Grossed-Up By ((H* 35)/(1-.35))				\$336,538		\$336,538		\$61,095
Other Expenses									
J	Annual Expenses, Other Than Income Taxes and Interest		\$3,000,000		\$3,000,000		\$3,000,000		\$3,000,000
K	Annual Interest Expense		\$500,000		\$500,000		\$500,000		\$500,000
Total Expenses									
L	Total Expenses (Base Year = F + J + K); First Year = I + J + K)		\$4,011,538		\$3,836,538		\$3,836,538		\$3,581,095
Revenue Requirement									
M	Annual Revenue Requirement (C + L)		\$4,961,538		\$4,961,538		\$4,961,538		\$4,686,095
Earnings Retained In The Business Calculations									
N	Revenue		\$4,961,538		\$4,961,538		\$4,961,538		\$4,686,095
O	Less: Expenses Other Than Income Taxes		\$3,500,000		\$3,500,000		\$3,500,000		\$3,500,000
P	Equals: C Corp Pre-Tax Earnings		\$1,461,538		\$1,461,538		\$1,461,538		\$1,186,095
Q	Less: C Corp Income Taxes = 35.0% of P = S Corp Shareholder Distributions		\$511,538		\$511,538		\$511,538		\$415,133
R	Equals: Earnings Retained In The Business Before C Corp Dividends / S Corp Other Distributions		\$950,000		\$950,000		\$950,000		\$770,962
S	Earnings Retained In The Business / Net Investment In Assets		9.50%		9.50%		9.50%		7.71%

File:c:\123r4w\pc\fcc71594\scorptx4(7/6/94-10:39)

Notes:

1. For Purposes of Illustration, This Example Uses The Top Federal Rate of C Corp's, Even Though The Top Rate For S Corp's Owners Is Higher (39.6%).
2. S Corp's Distributions To Shareholders For Income Taxes On Cable Entity Earnings Are Functionally The Same As C Corp Payments To Taxing Authorities.
3. Earnings Retained In The Business Of Both C Corp And S Corp Are After Respective Allowances For Income Taxes. Therefore Dividends By C Corp And Other Distributions By S Corp Are Functionally The Same For The Respective Cable Entities And Rate Payers. Both Have Had An Allowance For Income Taxes Attributed To The Respective Earnings And Neither Creates An Additional Income Tax Allowance For Rate Payers To Fund. Therefore Both Should Be Treated The Same.

Example 2 - Current FCC Form 1205 Format (Produces Incorrect Results For FCC Form 1205 Cells G6e and G7 - See Example 3 For Revised Corrected Version)

Comparison of Disparate Effects of New Rules On Income Tax Reimbursement Between C Corporations and S Corporations, Partnerships and Sole Proprietorships ("S Corp's")

Assumed Results For Base Year For Both C Corp And S Corp Cable Company Examples With Differently Determined ROR's
(Assuming Same Regulatory Treatment For C Corp And S Corp)

First Year's Results Based on Base Year's Expense Structure Under "Revised" Rate Rules:

Revenue Requirement Calculations		I Results For C Corp & S Corp Cable Companies If ROR (B) Is All After-Tax		II Results For C Corp & S Corp Cable Companies If Debt Portion Of ROR (B) Is Pre-Tax And Equity Portion Is After-Tax		III For C Corp - Allowed For Rate Setting		IV For C Corp - Allowed For Rate Setting	
ROI									
A	Net Investment In Assets (FCC Form 1205 G4b)		\$10,000,000		\$10,000,000		\$10,000,000		\$10,000,000
B	Fair Rate of Return p.a. (FCC Form 1205 F) (Debt = Pre-Tax; Equity = After-Tax)		11.25%		11.25%		11.25%		11.25%
B1	Fair Rate of Return p.a. (FCC Form 1205 F) (Debt and Equity = After Tax) (See Separate Notes For Formula)		9.50%		na		na		na
Income Tax Rate Adjustment For Interest									
C	Assume Only Federal Income Tax Rate (FCC Form 1205 G1 & G3)		35.00%		35.00%		35.00%		35.00%
D	Interest Expense (FCC Form 1205 G4a)		\$500,000		\$500,000		\$500,000		\$500,000
E	Base Return On Investment Amount (Column I = A * B1; Rest = A * B) (FCC Form 1205 G4c)		\$950,000		\$1,125,000		\$1,125,000		\$1,125,000
F	Interest Deductibility Factor (D/E) (FCC Form 1205 G4d)				0.4444		0.4444		0.4444
G	Effective Tax Rate (C * (1-F)) (FCC Form 1205 G5)				0.1944		0.1944		0.1944
S-Corp Adjustment For Shareholder Distributions									
H	Base Return On Investment Amount (E) (FCC Form 1205 G8a)				na		na		\$1,125,000
I	Distributions (Assume Only = % Base Year Column I Income Taxes Paid = Q) (FCC Form 1205 G8b)				na		na		\$488,793
J	Returns Subject To Income Tax (H - I) (FCC Form 1205 G8d)				na		na		\$636,207
K	Returns Percentage Subject To Income Tax (J/H) (FCC Form 1205 G8e)				na		na		0.5655
Grossed-Up ROI									
L	Gross-Up Rate: C Corp = (1/(1-G)); S Corp = (1/(1-(G*K))) (FCC Form 1205 G7)				1.2414		1.2414		1.1235
M	Grossed-Up Rate of Return (B * L) (FCC Form 1205 H)				0.1397		0.1397		0.1264
N	Return On Investment Grossed-Up For Taxes (A * M) (FCC Form 1205 I)				\$1,396,552		\$1,396,552		\$1,263,991
Expenses (Other Than Income Tax Allowance For Columns II and III) (Same As For Example 1 For Comparability)									
O	Annual Income Tax Allowance On Return On Investment For Base Year Column I = 35.00%		\$511,538		na		na		na
P	Annual Expenses, Other Than Income Taxes and Interest		\$3,000,000		\$3,000,000		\$3,000,000		\$3,000,000
Q	Annual Interest Expense		\$500,000		\$500,000		\$500,000		\$500,000
R	Equals: Total Expenses: Base Year Column I = O + P + Q; Rest = P + Q		\$4,011,538		\$3,500,000		\$3,500,000		\$3,500,000
Revenue Requirement									
S	Annual Revenue Requirement: Base Year Column I = E + R; Rest = N + R		\$4,961,538		\$4,896,552		\$4,896,552		\$4,763,991
Earnings Retained In The Business Calculations									
T	Revenue		\$4,961,538		\$4,896,552		\$4,896,552		\$4,763,991
U	Less: Expenses Other Than Income Taxes		\$3,500,000		\$3,500,000		\$3,500,000		\$3,500,000
V	Equals: Pre-Tax Earnings		\$1,461,538		\$1,396,552		\$1,396,552		\$1,263,991
W	Less: Income Taxes: C Corp = 35.00% of O = Assumed Only S Corp Shareholder Distributions		\$511,538		\$488,793		\$488,793		\$442,397
X	Equals: Earnings Retained In The Business Before C Corp Dividends/S Corp Other Distributions		\$950,000		\$907,759		\$907,759		\$821,594
Y	Earnings Retained In The Business/Net Investment In Assets		9.50%		9.08%		9.08%		8.22%

File: c:\123r4w\pcc\71594\scorp\5\7/8/94-10:41)

Notes:

- For Purposes of Illustration, This Example Uses The Top Federal Rate of C Corp's, Even Though The Top Rate For S Corp's Owners is Higher (39.6%).
- S Corp's Distributions To Shareholders For Income Taxes On Cable Entity Earnings Are Functionally The Same As C Corp Payments To Taxing Authorities.
- Earnings Retained In The Business Of Both C Corp And S Corp Are After Respective Allowances For Income Taxes. Therefore Dividends By C Corp And Other Distributions By S Corp Are Functionally The Same For The Respective Cable Entities And Rate Payors. Both Have Had An Allowance For Income Taxes Attributed To The Respective Earnings And Neither Creates An Additional Income Tax Allowance For Rate Payors To Fund. Therefore Both Should Be Treated The Same.
- There Are Incorrect Formulas In Rows K and L, Which Produce Results Different From Those In Example 1. Example 3 Contains Corrected Formulas and Results.

Example 3 - FCC Form 1205 Format - Revised To Match Cost of Service Results (FCC Form 1205 Cell Formulas G6e And G7 Revised)

Comparison of Disparate Effects of New Rules On Income Tax Reimbursement Between C Corporations and S Corporations, Partnerships and Sole Proprietorships ("S Corp's")

Assumed Results For Base Year For Both C Corp And S Corp Cable Company Examples With Differently Determined ROR's
(Assuming Same Regulatory Treatment For C Corp And S Corp)

Revenue Requirement Calculations

		I Results For C Corp & S Corp Cable Companies If ROR (B) Is All After-Tax \$10,000,000	II Results For C Corp & S Corp Cable Companies If Debt Portion Of ROR (B) Is Pre-Tax And Equity Portion Is After-Tax \$10,000,000
RQI			
A	Net Investment In Assets (FCC Form 1205 G4b)		
B	Fair Rate of Return p.a. (FCC Form 1205 F) (Debt = Pre-Tax; Equity = After-Tax)	11.25%	11.25%
B1	Fair Rate of Return p.a. (FCC Form 1205 F) (Debt and Equity = After Tax) (See Separate Notes For Formula)	9.50%	na
Income Tax Rate Adjustment For Interest			
C	Assume Only Federal Income Tax Rate (FCC Form 1205 G1 & G3)	35.00%	35.00%
D	Interest Expense (FCC Form 1205 G4a)	\$500,000	\$500,000
E	Base Return On Investment Amount (Column I = A * B1; Rest = A * B) (FCC Form 1205 G4c)	\$950,000	\$1,125,000
F	Interest Deductibility Factor (D/E) (FCC Form 1205 G4d)		0.4444
G	Effective Tax Rate (C * (1-F)) (FCC Form 1205 G5)		0.1944
S-Corp Adjustment For Shareholder Distributions			
H	Base Return On Investment Amount (E) FCC Form 1205 G6a)		na
I	Distributions (Assume Only S's Base Year Column I Income Taxes Paid = Q) (FCC Form 1205 G6b)		na
J	Returns Subject To Income Tax (H - I) (FCC Form 1205 G6d)		na
K	Returns Percentage Subject To Income Tax ((J-D)/(H-D)) (FCC Form 1205 G6e)		na
Grossed-Up RQI			
L	Gross-Up Rate: C Corp = ((G/(1-C))+1); S Corp = (((G*K)/(1-C))+1) (FCC Form 1205 G7)	1.2991	
M	Grossed-Up Rate of Return (B * L) (FCC Form 1205 H)		0.1462
N	Return On Investment Grossed-Up For Taxes (A * M) (FCC Form 1205 I)		\$1,461,538
Expenses (Other Than Income Tax Allowance For Columns II and III) (Same As For Example 1 For Comparability)			
O	Annual Income Tax Allowance On Return On Investment For Base Year Column I = 35.00%	\$511,538	na
P	Annual Expenses, Other Than Income Taxes and Interest	\$3,000,000	\$3,000,000
Q	Annual Interest Expense	\$500,000	\$500,000
R	Equals: Total Expenses: Base Year Column I = O + P + Q; Rest = P + Q	\$4,011,538	\$3,500,000
Revenue Requirement			
S	Annual Revenue Requirement: Base Year Column I = E + R; Rest = N + R	\$4,961,538	\$4,961,538
Earnings Retained In The Business Calculations			
T	Revenue	\$4,961,538	\$4,961,538
U	Less: Expenses Other Than Income Taxes	\$3,500,000	\$3,500,000
V	Equals: Pre-Tax Earnings	\$1,461,538	\$1,461,538
W	Less: Income Taxes: C Corp = 35.00% of O = Assumed Only S Corp Shareholder Distributions	\$511,538	\$511,538
X	Equals: Earnings Retained In The Business Before C Corp Dividends/S Corp Other Distributions	\$950,000	\$950,000
Y	Earnings Retained In The Business/Net Investment In Assets	9.50%	9.50%

First Year's Results Based on Base Year's Expense Structure Under "Revised" Rate Rules:

Revenue Requirement Calculations

		III For C Corp - Allowed For Rate Setting \$10,000,000	IV For C Corp - Allowed For Rate Setting \$10,000,000
RQI			
A	Net Investment In Assets (FCC Form 1205 G4b)		
B	Fair Rate of Return p.a. (FCC Form 1205 F) (Debt = Pre-Tax; Equity = After-Tax)	11.25%	11.25%
B1	Fair Rate of Return p.a. (FCC Form 1205 F) (Debt and Equity = After Tax) (See Separate Notes For Formula)	na	na
Income Tax Rate Adjustment For Interest			
C	Assume Only Federal Income Tax Rate (FCC Form 1205 G1 & G3)	35.00%	35.00%
D	Interest Expense (FCC Form 1205 G4a)	\$500,000	\$500,000
E	Base Return On Investment Amount (Column I = A * B1; Rest = A * B) (FCC Form 1205 G4c)	\$1,125,000	\$1,125,000
F	Interest Deductibility Factor (D/E) (FCC Form 1205 G4d)	0.4444	0.4444
G	Effective Tax Rate (C * (1-F)) (FCC Form 1205 G5)	0.1944	0.1944
S-Corp Adjustment For Shareholder Distributions			
H	Base Return On Investment Amount (E) FCC Form 1205 G6a)	na	\$1,125,000
I	Distributions (Assume Only S's Base Year Column I Income Taxes Paid = Q) (FCC Form 1205 G6b)	na	\$511,538
J	Returns Subject To Income Tax (H - I) (FCC Form 1205 G6d)	na	\$613,462
K	Returns Percentage Subject To Income Tax ((J-D)/(H-D)) (FCC Form 1205 G6e)	na	0.1815
Grossed-Up RQI			
L	Gross-Up Rate: C Corp = ((G/(1-C))+1); S Corp = (((G*K)/(1-C))+1) (FCC Form 1205 G7)	1.2991	1.0543
M	Grossed-Up Rate of Return (B * L) (FCC Form 1205 H)	0.1462	0.1186
N	Return On Investment Grossed-Up For Taxes (A * M) (FCC Form 1205 I)	\$1,461,538	\$1,186,095
Expenses (Other Than Income Tax Allowance For Columns II and III) (Same As For Example 1 For Comparability)			
O	Annual Income Tax Allowance On Return On Investment For Base Year Column I = 35.00%	na	na
P	Annual Expenses, Other Than Income Taxes and Interest	\$3,000,000	\$3,000,000
Q	Annual Interest Expense	\$500,000	\$500,000
R	Equals: Total Expenses: Base Year Column I = O + P + Q; Rest = P + Q	\$3,500,000	\$3,500,000
Revenue Requirement			
S	Annual Revenue Requirement: Base Year Column I = E + R; Rest = N + R	\$4,961,538	\$4,686,095
Earnings Retained In The Business Calculations			
T	Revenue	\$4,961,538	\$4,686,095
U	Less: Expenses Other Than Income Taxes	\$3,500,000	\$3,500,000
V	Equals: Pre-Tax Earnings	\$1,461,538	\$1,186,095
W	Less: Income Taxes: C Corp = 35.00% of O = Assumed Only S Corp Shareholder Distributions	\$511,538	\$415,133
X	Equals: Earnings Retained In The Business Before C Corp Dividends/S Corp Other Distributions	\$950,000	\$770,962
Y	Earnings Retained In The Business/Net Investment In Assets	9.50%	7.71%

File:c:\123r4w\pcc\fcc71594\isccpbx\7/9/94-10:44

Notes:

- For Purposes of Illustration, This Example Uses The Top Federal Rate Of C Corp's, Even Though The Top Rate For S Corp's Owners Is Higher (38.6%).
- S Corp's Distributions To Shareholders For Income Taxes On Cable Entity Earnings Are Functionally The Same As C Corp Payments To Taxing Authorities.
- Earnings Retained In The Business Of Both C Corp And S Corp Are After Respective Allowances For Income Taxes. Therefore Dividends By C Corp And Other Distributions By S Corp Are Functionally The Same For The Respective Cable Entities And Rate Payors. Both Have Had An Allowance For Income Taxes Attributed To The Respective Earnings And Neither Creates An Additional Income Tax Allowance For Rate Payors To Fund. Therefore Both Should Be Treated The Same.
- Formulas In Rows K and L (FCC Form 1205 Cells G6e and G7) Have Been Corrected And, In Example 3, Produce The Same Results As Those In Example 1.